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Supreme Court of the United States

OCTOBER TERM, 1941.

No. 248.

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

v.

LERNER STORES CORPORATION (MD.),
Respondent.

BRIEF FOR THE RESPONDENT IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

ANDREW B. TRUDGIAN,
Counsel for Respondent.

THE COURT PRESS, 130 Cedar Street, N. Y. C.

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Opinions Below.

The opinion of the United States Board of Tax Appeals (R. 16-18) is not reported. The opinion of the United States Circuit Court of Appeals for the Second Circuit (R. 28-30) is reported in 118 F. (2d) 455.

Jurisdiction.

The decision of the United States Circuit Court of Appeals was rendered on March 24, 1941 (R. 28). The order for mandate was filed April 12, 1941 (R. 31). The petition for writ of certiorari was filed in the Supreme Court of the United States on July 8,

1941. Petitioner invokes the jurisdiction of this Court under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

Questions Presented.

1—Whether the petition for writ of certiorari was filed within the period specified by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925?

2—Whether respondent, before the end of its income tax taxable year, may correct a figure of $25,000, inserted on its capital stock tax return as the result of the clerical error of a subordinate employee, although the figure of $2,500,000 was actually intended and decided upon by the respondent?

3—Whether the excess-profits tax is valid and constitutional under the Constitution of the United States of America?

Statutes and Regulations Involved.

The statutes and regulations involved are set forth in the Appendix, *infra*, pages 9-10.

Statement of Facts.

The petitioner duly filed a capital stock tax return for the year ended June 30, 1936, showing a declared value as of January 31, 1936, in the amount of $25,000. The officer supervising the filing of the capital stock tax returns for the respondent and its fifty-two subsidiaries decided upon a declared value in the amount of $2,500,000, and so instructed his subordinates.

However, through a clerical error on the part of a subordinate employee engaged in manually preparing the return, the $25,000 figure was actually inserted on the return (R. 16). Upon discovery of the error prior to the expiration of petitioner's fiscal year, on January 27, 1937 the respondent filed an amended capital stock tax return showing the correct amount of $2,500,000 (R. 17).

The Commissioner of Internal Revenue refused to accept the amended return, or to recognize the corrected declared value in the amount of $2,500,000. In computing the ten per cent. of the declared value as of January 31, 1936, allowed as a deduction in determining the amount of the net income of the respondent subject to excess-profits tax for the fiscal year ended January 31, 1937, the Commissioner employed the declared value appearing on the first capital stock tax return, viz., $25,000 (R. 17). This resulted in a deficiency of $27,947.38 in excess-profits tax (R. 8).

From this determination the petitioner appealed to the United States Board of Tax Appeals, which sustained the Commissioner (R. 18), but the Circuit Court of Appeals reversed the Board (R. 31).

The Circuit Court of Appeals rendered its decision on March 24, 1941 (R. 28). At the conclusion of its decision the Circuit made the following statement (R. 30):

> "Order reversed."

The order for mandate was filed on April 12, 1941 (R. 31).

Argument.

I—This Court has no jurisdiction to grant the petition for writ of certiorari because said petition was not filed within the period specified by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

The governing statute, Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925, provides that no writ of certiorari shall be entertained unless the petition is filed "within three months after the entry of such judgment or decree * * *."

The respondent contends that "the judgment or decree" is contained in the decision of the Circuit Court of Appeals, rendered on March 24, 1941 (R. 28). The decision is not merely a statement of the reasons, but embodies the "judgment" of the Court. After stating its reasons (R. 28-30), the court states unequivocally its judgment at the conclusion in the words "Order reversed." Those words constitute unmistakably the judgment of the court, which under the rules of the court (Rule XXVI, United States Circuit Court of Appeals, Second Circuit) "shall, immediately upon the delivery thereof, be handed to the clerk to be recorded." Presumably the recording or entry of the judgment or decision was made on March 24, 1941, the date on which the decision was delivered. At any rate the petitioner, upon whom the burden of establishing jurisdiction rests, does not show that the recording required by the Rules was made subsequent to March 24, 1941. Hence the three month statutory limitation expired on June 24, 1941, which was prior to July 10, 1941, the date upon which the petition was filed.

Webster's New International Dictionary of the English Language (1932) gives the following definitions (italics supplied):

Judgment—

"1. The pronouncing of an *opinion* or *decision* of a formal or authoritative nature; also, the *opinion* or *decision* given.

2. Law. The act of determining, as in courts, what is conformable to law and justice; * * *."

Entry—

"2. Act of making or entering a *record*."

Enter—

"7. To inscribe; enroll; *record*; * * *."

Decree—

"1. An *order* or *decision* from one having authority *deciding* what is, or is to be, done; a *determination* by one having power *deciding* what is to be done or to take place; authoritative *decision*; * * *.

4. Law. A judicial *decision* * * *."

Clearly on March 24, 1941 the court pronounced its "judgment" or "decree." Rule XXVI, *supra*, refers to it as an "opinion". The record states that it was "decided" on March 24, 1941 (R. 28). It concludes with the words "Order reversed," indicating clearly that a determination has been made. These words are themselves the judgment or decree of the court.

Just as clearly the judgment or decree was "entered" or, as Rule XXVI provides, "recorded" by

the clerk prior to the date of entry of the "Order for Mandate." The Order for Mandate is provided for by Rule XXX, which is entirely separate and distinct from the "recording" or "entry" provided for by Rule XXVI. Therefore, the three month statutory period does not run from the entry of the Order for Mandate, but from the date of the entry or recording of the opinion or decision.

II—The decision below is not in conflict with the decisions in *William B. Scaife & Sons Co.* v. *Commissioner*, 117 F. (2d) 572 (C. C. A. 3rd, 1941) and *Riley* v. *Commissioner*, 311 U. S. 55 (1940).

The *Scaife* case did not involve a clerical error of a subordinate employee. Neither the opinion of the Third Circuit nor of the Board of Tax Appeals indicate that the error was a clerical error rather than an error of judgment or discretion on the part of the treasurer. The treasurer, who committed the error in preparing the return, was a responsible officer who was vested with power to prepare the return alone. *U. S. Treas. Reg. 64 (1936 Edition) Article 36.* It does not appear that the treasurer, intending to insert the $1,000,000 figure, inserted the $600,000 figure as the result of a clerical error. The published opinions do not indicate that any evidence was introduced to the effect that the error of the treasurer was not an error of judgment. In the instant case, on the other hand, there is no dispute as to the nature of the error. As the lower court stated:

> "But we are not confronted with a change of judgment by the taxpayer; the case at bar presents a situation where the taxpayer has made but one 'declaration of value' and has inac-

curately reported it to the Commissioner due to an error of one of its employees. The correction of such a clerical error before the Commissioner has acted in reliance upon it in computing taxes for a later year cannot thwart the purposes of the statute or injure the interests of the Government."

The distinction between the *Scaife* case and the instant case, *i. e.*, the distinction between an error of judgment and a clerical error, is adverted to by the court below:

"* * * the amendment must not be used to substitute a declared valuation more favorable in the light of later events than the one originally decided upon and reported by the taxpayer. See *Riley Co.* v. *Commissioner,* 311 U. S. 55, 59. But granted that the valuation stated in the return was due to a clerical error, we think no sound reason can be advanced for not permitting it to be corrected before the Commissioner has acted in reliance on it. Not to do so deprives the taxpayer of the privilege the statute accords to exercise its own judgment in fixing the taxable base."

The court below also effectively disposes of the respondent's contention that its decision is in conflict with the *Riley* case. As the court stated:

"This case [*Riley* v. *Commissioner*] would be apposite if the petitioner at bar were attempting by amendment to change its judgment of the value to declare for its stock. It is not controlling where the amendment seeks to correct a clerical error in the return. Mr. Justice Douglas

was careful to state at page 58, 'We are not dealing with an amendment designed merely to correct errors and miscalculations in the original return. Admittedly the Treasury has been liberal in accepting such amended returns even though filed after the period for filing original returns.' * * *"

In conclusion, it may be pointed out that the decision below presents no question of importance. The facts, relating to a purely clerical error of a subordinate employee, present a highly unusual and novel situation which is not likely to recur.

CONCLUSION.

The petition for writ of certiorari should be denied.

Respectfully submitted.

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APPENDIX.

JUDICIAL CODE. SECTION 240 (a), AS AMENDED BY THE ACT OF FEBRUARY 13, 1925.

No appeal, or writ of certiorari, intended to bring any judgment or decree before the Supreme Court for review shall be allowed or entertained unless application therefor be duly made within three months after the entry of such judgment or decree, excepting that writs of certiorari to the Supreme Court of the Philippine Islands may be granted where application therefor is made within six months. * * *

UNITED STATES TREASURY REGULATIONS 64 (1936 EDITION), ARTICLE 36.

Verification of return.—The return, as well as any separate statement submitted herewith, must be verified under oath or affirmation by at least one of the responsible officers of the corporation, and preferably by the president and the treasurer. * * *

RULES OF UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Rule XXVI. Opinions of the Court.

1. All opinions delivered by the Court shall, immediately upon the delivery thereof, be handed to the clerk to be recorded.

2. The original opinions of the Court shall be filed with the clerk of this Court for preservation.

3. Opinions printed under the supervision of the judge delivering the same need not be copied by the clerk into a book of records; but at the end of each term the clerk shall cause such printed opinions to be bound in a substantial manner into one or more

volumes, and when so bound they shall be deemed to have been recorded within the meaning of this rule.

Rule XXX. Taxing Costs—Order—Mandate.

1. Upon the filing of any decision by this Court the clerk shall forthwith, or at any later time, if the court thinks justice requires it, enter the proper order, and will thereupon prepare and tax the bill of costs, giving to the parties reasonable time to file with him their proposed orders and bill of costs, with proof of service of the same upon their opponents.

2. A mandate may issue at any time on order of this court, but unless otherwise ordered shall issue at the expiration of fifteen days from the filing of the opinion of this court in the clerk's office unless delayed by the filing of the petition for rehearing. * * *

BRIEF FOR THE RESPONDENT

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Opinions Below

The opinion of the United States Board of Tax Appeals (R. 16-18) is not reported. The opinion of the United States Court of Appeals for the Second Circuit (R. 28-30) is reported in 118 F. (2d) 455.

Jurisdiction

The judgment of the United States Circuit Court of Appeals was entered April 12, 1941 (R. 31). The petition for a writ of certiorari was filed on July 8, 1941, and was granted October 13, 1941. The jurisdiction of this Court is conferred by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

Questions Presented

(1) Whether the taxpayer, which filed a timely capital stock tax return for the year ended June 30, 1936, showing, as the result of a clerical error by an employee, a declared value of $25,000, had the right to file on January 27, 1937, before the end of its income tax year, February 1, 1936-January 31, 1937, an amended return correcting its declaration to $2,500,000?

(2) Whether the Excess Profits Tax imposed by Section 106 of the Revenue Act of 1935, as amended by Section 402 (a) of the Revenue Act of 1936, was constitutional under the Constitution of the United States of America.

Statutes and Regulations Involved

The pertinent statutes and regulations are set forth in the appendix, *infra*, pages 23 to 28.

Statement

Taxpayer was the owner of fifty-two subsidiary companies and its income consisted of dividends from the latter. It was granted an extension of time to September 29, 1936, within which to file its capital stock tax return for the year ended June 30, 1936. Pursuant to that extension, on September 27, 1936, it filed a capital stock tax return in which it declared a value of $25,000.00 for its capital stock. In the computation of tax on that return, the tax due was reported as $25.00 and the interest was reported as twenty-five cents, making a total of $25.25. The return was signed by J. H. Hersch and Graham Magee.

both of whom were vice-presidents of taxpayer, and was duly sworn to by them under oath (R. 16).

The figure of $25,000.00 entered on the return was erroneous; the error arose through a mistake made by an employee of the taxpayer (R. 16).

On January 27, 1937, taxpayer forwarded a document prepared on Form 707 (the capital stock tax return form), which was stated to be an amended capital stock tax return for the year ended June 30, 1936. Under item 8 of this form, opposite the words "Declared Value of Entire Capital Stock", the figure $2,500,000.00 was entered. The amount of tax, penalty and interest computed by the taxpayer on the form was $3,090.00, consisting of a tax of $2,500.00, a penalty of $500.00, and interest of $90.00 (R. 17).

The mistake in the first return was discovered by Hersch in the course of going over taxpayer's accounts prior to the end of taxpayer's fiscal year, which ended January 31, 1937 (R. 17).

By letter dated July 12, 1937, the Commissioner advised the taxpayer that the declaration of value on the document sought to be filed as an amended return could not be accepted. The amount of money paid in connection with the amended return was refunded to the taxpayer (R. 17).

In computing the deduction of 10% of the declared value of the taxpayer's capital stock in determining taxpayer's net income subject to the excess profits tax for the fiscal year ended January 31, 1937, the Commissioner employed the declared value of $25,000.00 appearing on the first capital stock return (R. 17). On this basis he determined a deficiency of $27,947.38 in excess profits tax (R. 8). The Board of Tax Appeals sustained this action of the Commissioner (R. 18), but the Circuit Court of Appeals reversed (R. 31).

Summary of Argument

The erroneous figure of $25,000.00 resulted from a clerical mistake, not an error of judgment and accordingly was not an acceptance of the offer tendered by Section 105 of the Revenue Act of 1935 to declare a desired value. Under the general law of contracts this inadvertent mistake of an employee was not binding and the general law was not altered by any act of Congress because no expression of such a harsh intent is to be found in the statute.

The intent of the statute was to allow a taxpayer to choose its base for the first taxable year and the amount thus fixed was to be accepted, with such changes as the statute prescribed, for the purpose of computing capital stock and excess profits taxes in following years. What was declared in the first year was immaterial, taxpayers being given the widest election. The choice was to be made in the return filed for the first year, such return not being limited to the first piece of paper filed for the year, but including a timely amended return. A timely amended return would include one filed before the end of the first income and excess profits tax year ending after the capital stock declaration year.

The excess profits tax imposed by Section 106 of the Revenue Act of 1935, as amended, and the related capital stock tax imposed by Section 105 of the Revenue Act of 1935, as amended, are unconstitutional as constituting an unlawful delegation of legislative authority to taxpayers contrary to Article 1, Section 8 of the Constitution of the United States of America; also because the operation of these sections are so arbitrary and capricious as to violate the Fifth Amendment of the Constitution, and to be

entirely in violation of its spirit and intent with the result that the power to enact such legislation was never granted to Congress.

Argument

I.

The taxpayer is not bound by the clerical error resulting in the statement of an erroneous value.

As stated by the Court in the case of *Patch* v. *White*, 117 U. S. 210:

> "Dr. Johnson, in the preface to his Dictionary well says: 'Sudden fits of inadvertence will surprise vigilance, slight avocations will seduce attention, and casual eclipses of the mind will darken learning.' Not to allow the correction of such evident slips of attention, when there is evidence by which to correct it, would be to abrogate the old maxim of the law: '*Falsa demonstratio non nocet.*'"

The courts have always felt the necessity of the application of this doctrine with respect to themselves and permitted the correction of clerical errors in relation to their proceedings *nunc pro tunc*. *St. Louis & S. F. R. Co.* v. *Spiller*, 275 U. S. 156; *Marsh* v. *Nichols, S. & Co.*, 128 U. S. 605, 615; *Wetmore* v. *Karrick*, 205 U. S. 141. They have also recognized its necessity in the case of inadvertent descriptions in deeds of property, *Williams* v. *United States*, 138 U. S. 514; *Camp* v. *Boyd*, 229 U. S. 530; *Morrison* v. *Stalnaker*, 104 U. S. 213; references to the wrong statute, *Johnson Co. Comrs.* v. *January*, 4 Otto (94

U. S.) 202; and errors in wills, *Patch* v. *White*, 117 U. S. 210.

So far as contracts are concerned, as stated in the Restatement, Contracts, Section 502:

> "* * * where parties on entering into a transaction that affects their contractual relations are both under a mistake regarding a fact assumed by them as the basis on which they entered into the transaction, it is voidable by either party if the enforcement of it would be materially more onerous to him than it would have been had the fact been as the parties believed it to be * * *"

and again in Section 502 of the Restatement, under "Comment":

> (a) * * * Where both parties assume the existence of a certain state of facts as the basis on which they enter into a transaction, the transaction can be avoided by a party who is harmed, if the assumption is erroneous. It is immaterial whether the mistake affects identity of persons or things, or the attributes of either persons or things, or other facts. It is the assumed existence of the fact to which the mistake relates as the basis on which the parties bargained, that is important.

Also 5 Williston on Contracts (Rev. ed. 1936), Section 1547:

> "Where a written agreement is not in conformity with the actual intention of the parties in a material matter, a court of equity will reform the writing in accordance with that intention if innocent parties will not be affected thereby."

The taxes imposed by Sections 105 and 106 of the Revenue Act of 1935 resulted in contracts with taxpayers. Under these sections taxpayers were given the choice of methods of taxation and the acceptance of one precluded to a more or less extent the application of the other. If the taxpayer would pay the government a sufficient consideration under Section 105 it would not be taxed under Section 106. That this is so is established by the following quoted from the "Report—Senate Finance Committee" (73rd Cong., 1st Sess. S. Rept. 114) on Sections 215 and 216 of the National Industrial Recovery Act, 48 Stat. 195, imposing the first capital stock and excess profits taxes of the type imposed by Sections 105 and 106 of the Revenue Act of 1935:

> "Section 214 provides for a new tax similar in principle to the capital stock tax which was levied from 1916 to 1926. In order to avoid controversy as to the value of the capital stock, the tax is imposed on the value declared by the corporation. A reasonable value is, however, assured by means of an excess profits tax imposed by Section 215 and based on the relation of the net income of the corporation to such declared value.
>
> * * *
>
> Section 215 imposes an excess profits tax on corporations. The primary object of this tax is to induce corporations automatically to declare a fair value for their corporate stock under Section 214."

But while a return under Section 105 normally would have resulted in a contract this did not happen with respect to the present taxpayer by reason of its

declaration of $25,000.00 because of the principles of the law of contracts quoted above. The mistake made vitiated such declaration and the situation fell exactly within the scope of the above quoted doctrines. The mistake made was most material, the entire burden thereof fell upon the present taxpayer and the mistake was mutual. It was mutual because on the Government's side there was a failure to accomplish what the Government desired, the declaration of a value satisfactory to the taxpayer, *Haggar Co.* v. *Helvering*, 308 U. S. 389; and on the taxpayer's side, a failure to declare the value intended by the taxpayer.

Nor were the above general doctrines of contract modified in the instance of Sections 105 and 106 by Federal statute. This is so because the adoption of such a harsh, inequitable, and arbitrary rule as not permitting the correction of an inadvertent error cannot be imputed to Congress in the absence of some definite expression of intention on its part, or in the legislative record, and such is not to be found. 1 Paul and Mertens, Federal Income Taxation (1934), Section 3.05, states this rule of reasonable construction as follows:

> "It has become well-established that statutes should be given a reasonable interpretation and read in a 'practical' and 'sensible' light. What is meant by the word 'reasonable' in this connection, it is almost impossible to say. Generally speaking, an unreasonable result is one which leads to hardship, injustice, or absurdity * * *."

In Sharswood's Blackstones Commentaries, Volume 1, Section 2, page 60 is stated the following famous

instance when a reasonable construction of legislative enactment was adopted:

> "Therefore the Bolognian law, mentioned by Puppendorf, (b) which enacted 'that whoever drew blood in the streets should be punished with the utmost severity', was held after long debate not to extend to the surgeon who opened the vein of a person that fell down in the street with a fit."

That the doctrine is particularly applicable with respect to Federal tax laws appears from the following language of this Court in *Gould* v. *Gould,* 245 U. S. 151, holding:

> "In the interpretation of statutes levying taxes it is the established rule not to extend their prosions, by implication, beyond the clear import of the language used, or to enlarge their operations * * *"

So here, it is submitted that the words of the statute, fairly read in the light of the purpose disclosed by its terms, do not require the harsh and incongruous result of refusing to allow the correction of a clerical error honestly made. Attention may also be called to *Allied Agent, Inc.* v. *U. S.,* 26 F. Supp. 98, where the court indicated that the present case involving an honest clerical error, may well require a decision favorable to the taxpayer. In deciding adversely to the taxpayer in that case, the court said:

> "It will be observed that the petition does not allege that an honest mistake was made in any of the returns under consideration * * *."

II.

A taxpayer may elect to declare any value it sees fit in a timely amended return, and a return before the end of its first income tax year ending after the declaration year is timely.

In *Haggar Co.* v. *Helvering,* 308 U. S. 389, treating of Sections 215 and 216 of the National Industrial Recovery Act of 1933, 48 Stat. 195, 207, the original source of the type of capital stock and excess profits taxes imposed by Sections 105 and 106 of the Revenue Act of 1935, it was held:

> "The 'first return' as the context shows is the return for the first tax year of the taxpayer and the characterization of the return as 'first' is obviously used to distinguish the return made for the first year from the return 'for any subsequent year'. * * *"

In the *Haggar* case the Court also stated:

> "* * * the Commissioner concedes that the amount of the declared value of capital fixed for the first year is a matter of indifference to the Government * * *."

and again,

> "Here the purpose of the statute is unmistakable. It is to allow the taxpayer to fix for itself the amount of the taxable base for purposes of the computation of the capital stock tax, but with the proviso that the amount thus fixed for the first taxable year shall be accepted, with only such changes as the statute prescribes for the

purpose of computing the capital stock and excess profits taxes in later years. Congress thus avoided the necessity of prescribing a formula for arriving at the actual value of capital for the purpose of computing excess profits taxes, which had been found productive of much litigation under earlier taxing acts * * *."

Also

"but since the declared value for the first year is a controlling factor for the computation of taxes for later years, the statute provides that the declaration once made cannot be amended."

Moreover, the Court clearly recognized the effectiveness of an amended return in stating:

"Section 215 nowhere mentions amendment of returns or amended returns. It speaks of 'declared value' for the first tax year and provides that the 'declaration of value' cannot be amended. The 'declaration of value' is that of the corporation in its 'first return under this section.' The 'first return' as the context shows is the return for the first tax year of the taxpayer and the characterization of the return as 'first' is obviously used to distinguish the return made for the first year from the return 'for any subsequent year' in which the 'adjusted declared value' is required by the same section to conform to a formula based on the 'declared value' for the first year and which, for that reason, 'cannot be amended.'

"'First return' thus means a return for the first year in which the taxpayer exercises the privilege of fixing its capital stock value for tax

purposes, and includes a timely return for that year. * * *"

To quote once more:

> "A timely amended return is as much a 'first return' for the purpose of fixing the capital stock value in contradistinction to returns for subsequent years, as is a single return filed by the taxpayer for the first tax year."

So far as a timely return is concerned it is submitted that a return filed before facts pertaining to an income tax year succeeding the first income tax year were ascertained is timely regardless of the fact that it was filed after the due date. Such amended return was unaffected by the facts and figures of another year and, therefore, did not violate the legislative intent of keeping the years separate. Under the statute the declaration for the first year was to be the basis for succeeding years and not to be amended therein. So long, therefore, as the facts and figures of a succeeding year had not come into existence so that a declaration of the first year in an amended return was not in effect an amended declaration in the following period the amended return was timely.

III.

The capital stock and excess profits taxes imposed by Sections 105 and 106 of the Revenue Act of 1935, as amended, were invalid and unconstitutional under the Constitution of the United States of America.

1—*Sections 105 and 106 of the Revenue Act of 1935, as amended, constitute an unlawful delegation of legislative authority contrary to Article 1, Section*

8 of the Constitution of the United States of America.—The capital stock tax under Section 105, as stated in the law itself, was an excise tax and being an excise tax, under Section 8 of Article I of the Constitution had to be uniform throughout the United States. As specifically provided in paragraph (d) of Section 105, all provisions of law (included penalties) applicable in respect of the excise taxes imposed by Section 600 of the Revenue Act of 1926, so far as not inconsistent, were applicable to this excise tax. Returns of this excise tax had to be filed and were subject to the same provisions of law as excise returns under Title II of the Revenue Act of 1926.

On the other hand the excess profits tax under Section 106 was most clearly an income tax imposed on net income for the income year at two different rates for different brackets of income. In addition all provisions of law (including penalties) applicable with respect to the income tax imposed by Title I, the income tax title, of the Revenue Act of 1934, as amended, applied with respect to this tax. This tax, if it were not unconstitutional on other grounds, needed the authority of the Sixteenth Amendment of the Constitution for its existence. There was, of course, no rule of uniformity governing its operation as in the case of excise taxes.

Since under Sections 105 and 106 there were two distinct types of taxes, taxpayers were given the option of imposing on themselves a direct tax or an indirect tax as they desired. A taxpayer might declare no value for capital stock and thus elect the excess profits tax; or it might declare a tremendously large capital stock value and insure no imposition of excess profits tax; or it might by a medium declaration elect to pay both capital stock and excess profits taxes.

But under the Constitution of the United States the imposition of taxes is a function of Congress not to be delegated and any delegation thereof is unconstitutional. Article I, Section 8 of the Constitution confers on Congress alone the power to lay and collect taxes, and it is a fundamental principle that Congress may not delegate its legislative authority. See Black, American Constitutional Law (3rd ed.), 373 *et seq.*; *Field* v. *Clark*, 143 U. S. 649, 692; *Panama Refining Co.* v. *Ryan*, 293 U. S. 388; *United States* v. *Grimaud*, 220 U. S. 506.

Possibly the argument might occur that Congress had imposed both a capital stock tax and an excess profits tax on all corporate taxpayers and merely granted a credit in the case of the direct tax (excess profits) which would eliminate that tax in whole or part. But if Sections 105 and 106 are analyzed this argument fails. Upon careful reading of these sections it is found that for the first capital stock tax year the taxpayer could elect not to be taxed by declaring "none" as its capital stock value. In this way it would not have imposed a capital stock tax on itself for that year, but would have imposed excess profits tax on any net income it might realize for its first income year and, if there was income in the following years, on the income of such years. Or it could have declared a value so high that it would never have to pay any excess profits tax, but would have imposed on itself for all times a capital stock tax. Here there was no mere granting by Congress of a credit or deduction. Congress, on the other hand, had delegated to taxpayers the imposition of tax on themselves by giving them, in the case of the capital stock tax, the right to say whether there should be a tax and in the case of the excess profits tax whether or not there

should be a credit and, therefore, whether or not there should be an excess profits tax.

And here one of the evil possibilities of this type of delegated taxation must be pointed out. In this connection let it be supposed that a taxpayer is given the choice of one of two tax laws and there is selected the one that is unconstitutional. This would have been the case if there had been a tie-up of the income tax law and the Agricultural Adjustment Act and a taxpayer had selected the latter. Such a taxpayer would not have been taxed because it did not choose to levy a tax on itself. Moreover, this would have been the case if Sections 105 and 106 had existed before the adoption of the Sixteenth Amendment and a taxpayer had chosen Section 106. Therefore, while it may be of the greatest advantage from the viewpoint of convenience to link two laws, as was done in the case of Sections 105 and 106, for the purpose of securing the easy collection of the tax Congress desires to impose, nevertheless it is a dangerous system because it admits of taxpayers avoiding the tax that Congress primarily desires to levy.

2—*Sections 105 and 106 of the Revenue Act of 1935 are so arbitrary and capricious as to violate the Fifth Amendment of the Constitution of the United States of America.*—The excess profits tax, considered together with its related capital stock tax, is arbitrary and capricious in that it places a premium on the good luck or ability of the taxpayer to predict the amount of net income it will earn in the future. The taxpayer with less ability as a guesser, or in some instances, with less business acumen or opportunity, is heavily penalized and must bear a heavier burden than its more fortunate or able rival. In *Brushaber* v.

Union Pacific Railroad, 240 U. S. 1, 24-25 (1915), the Court recognized the invalidity of a tax which

> "was so arbitrary as to constrain to the conclusion that it was not the exertion of taxation but a confiscation of property, that is, a taking of the same in violation of the Fifth Amendment, or, what is equivalent thereto, was so wanting in basis for classification as to produce such a gross and patent inequality as to inevitably lead to the same conclusion."

See also:

Tyler v. *United States*, 281 U. S. 497, 504.

The statute likewise produces gross inequality in its effect on those businesses which involve more risks, and wider fluctuation in the amount of income. The more speculative business pays a higher rate of tax, either in the form of a greater capital stock tax paid for protective purposes, or in the form of a greater excess profits tax. On the other hand, the business with a steady flow of income bears a smaller tax burden because it knows, with a greater degree of accuracy, the amount of income it will earn.

Moreover, the tax operates unfairly against many taxpayers because of the ending dates of their fiscal years. Solely because the taxpayer herein has a fiscal year ended January 31st, it must bear a greater tax burden than one on the calendar year basis. This is because under Section 105 the capital stock tax is due on the same date for all corporations, regardless of their income tax taxable year. The capital stock tax returns for the year ended June 30, 1936 were due in the case of those who obtained the utmost limits of

extension on September 29, 1936, and at that time a corporation on a calendar year basis would have completed seven months of its income tax taxable year; whereas the petitioner, with an income tax taxable year ended January 31, 1937, would have completed only six months of its taxable year. The calendar year corporation would, therefore, be in a much better position to estimate the amount of its income as a guide in determining its capital stock declaration than the present taxpayer. The following types of situation, which are only a few of those that exist, amply illustrate the arbitrariness and capriciousness of the law:

Type I

Corporation A had an income-tax taxable year ended July 31, 1936. As provided in Section 105 (d) of the Revenue Act of 1935, as amended, it filed on July 31, 1936 a capital stock tax return as of June 30, 1936. It was able to declare a sufficient value to eliminate excess profits tax for the income tax year ended July 31, 1936, because when the capital stock return was filed it knew the results for its income tax year.

On the other hand the income year of Corporation B ran from July 1, 1936 to June 30, 1937. Under the law the declared value as of June 30, 1936 would be the basis of its excess profits tax credit for the year ended June 30, 1937. But B was in a most difficult situation. The "times" were uncertain and there were no operating results to guide the making of proper declaration. All B could do was to guess or wager in making a declaration.

Type II

Corporation A had an income year ended September 30, 1936. As provided in Section 105 (d) the Commissioner might extend the time for making returns for not more than 60 days. The declared value in the capital stock return of "A" as of June 30, 1936 was the basis of its excess profits credit for its year ended September 30, 1936. A obtained an extension of 60 days for filing its capital stock tax return as of June 30, 1936. Accordingly when it filed such return on September 29, 1936, it knew what value to declare because it knew the results of its income year ended September 30, 1936.

Corporation B had an income-tax taxable year ended January 31, 1937. It obtained a sixty-day extension for filing its capital stock tax return for the year ended June 30, 1936, the value declared in which was the basis for its excess profits credit for the year ended January 31, 1937. But when on September 29, 1936, it filed its capital stock tax return as of June 30, 1936, it could not guess what would be the results of its operations for the months of October, 1936 to January 31, 1937, inclusive, the most important operating months of its income year. Moreover, the "times" were "panicky" and previous experiences were no guide. All that Corporation B could do, therefore, was to make the wildest kind of a guess or wager in declaring its value.

Type III

Corporation A and B, both in the same type of business, had income-tax taxable years ended August 31, 1936. Both applied for 60 day extensions for filing

capital stock tax returns as of June 30, 1936, the declared values in which were to be the bases of their excess profits credits for their years ended August 31, 1936. Corporation A obtained its extension because its auditor was ill but the request of Corporation B was refused and it had to file its return on July 31, 1936, a month before the end of its income year. It made its declaration of value on the basis of past experience but because of an inventory condition in August, 1936 such value was wrong and excess profits tax resulted. Corporation A, however, while it experienced the same inventory condition did not file its capital stock return until September 29, 1936, a month after the close of its income year. It accordingly knew the effect of the inventory situation and was able to declare properly.

Type IV

Corporation A has income consisting in large part from dividends. Corporation B is engaged in an ordinary mercantile business. Corporation B is in a good position to estimate its net income, since the business is within its control and under its management. Corporation A, on the other hand, has no control over the management of the corporation from whom it receives dividends. It has no close source of information as to the expected profit of these corporations. The declaration of dividends is subject to the judgment or caprice of directors not under its control. Unlike Corporation B, it is in no position to estimate accurately its earnings for the ensuing year.

While these instances are sufficient to prove the unconstitutionality of Sections 105 and 106, it is felt

necessary to mention the fact that a taxpayer which filed no return until discovered could occupy a more favorable position from a tax point of view than the taxpayer who guessed wrong, or made mistakes, but filed on time and tried to obey the law. The latter would have sufficient knowledge to declare a value which would prevent the imposition of excess profits tax and, though there might be a 50% penalty and interest due because of its delinquency, the capital stock tax, penalty, and interest would not equal the excess profits tax and interest of the taxpayer who did its best but made a mistake.

3—*Sections 105 and 106 of the Revenue Act of 1935 are unconstitutional, the so-called taxes levied thereunder being based on guesses and wagers and there being no authority delegated to Congress to pass such laws.*

Sir William Blackstone in his commentaries refers to

> "Caligula, who (according to Dio Cassius) wrote his laws in a very small character, and hung them upon high pillars, the more effectually to ensnare the people." Sharswood's Blackstones Commentaries, Volume I, Sect. 246.

While the script of Sections 105 and 106 is clear enough, they and all capital stock laws that require the fixing of a capital stock tax base today for all times are equally as ensnaring. How can a taxpayer today fix a value to cover the unexpected happenings of future years. This, of course, has been and will be impossible and the court is requested to take judicial notice of the uncertainties of the period during which

the country has been passing and the wide and unexpected results in operations arising from inventory fluctuations and other factors.

Sections 105 and 106 merely afford the taxpayer an opportunity to wager on an entirely fortuitous event, the amount of income it will earn. A reading of the Constitution nowhere reveals any authority for the raising of national revenue by a wager whether on the throw of dice, the turn of a wheel, or gambling on some future happening. True Congress has plenary power to tax, but no power to enact legislation of this type. Certainly the Government has no authority to provide that one of its principal officers must roll dice with taxpayers and, if the Government wins, to collect the results. Nor has it power to enact the so-called taxes included under Sections 105 and 106, which equally call for wagers except that the dice game would be fairer as all would be left to chance, and there would be no favoring of a few who are in a favored position in playing the wheel of capital stock and excess profits tax.

As to a claim that the scheme of these taxes is desirable and proper because they merely simplify the administration of a capital stock tax law by preventing the disputes as to true value that arose under former capital stock tax laws, the answer is plain. There would be validity to such a contention if an annual declaration of value had been permitted to taxpayers. If the tax were imposed on actual value such value would differ at the different tax dates. A true substitute for this type of law would at least admit of annual declarations. But on the other hand taxpayers were to declare values for all time and the tax was to apply on such adjusted declared values although they

might come to represent no reasonable values at all because of the disappearance or depreciation of assets behind them. It is submitted that there is no where a grant to Congress under the Constitution to tax nothing but an amount written on a piece of paper some years before. Congress may tax persons, things or transactions without limit, but surely it does not have the right to tax in later years the remaining balance of a wild guess or figment of the imagination.

While it is recognized that acts of the National legislature are only to be held unconstitutional where there is not the slightest doubt as to their unconstitutionality, it is urged that such is the situation with respect to Sections 105 and 106. It is, moreover, submitted that the lawful objects of taxation are numerous in the extreme and there is no need from the viewpoint of the National revenue to resort to laws which operate as traps or pitfalls to catch the unwary and require the gift of prophecy on the part of taxpayers in determining the basis for their tax.

CONCLUSION.

The decision of the Circuit Court of Appeals should be affirmed.

Respectfully submitted,

ANDREW B. TRUDGIAN,
Counsel

Appendix

Revenue Act of 1935, c. 829, 49 Stat. 1014:

SEC. 105. CAPITAL STOCK TAX [as amended by Section 401 of the Revenue Act of 1936, c. 690, 49 Stat. 1648].

(a) For each year ending June 30, beginning with the year ending June 30, 1936, there is hereby imposed upon every domestic corporation with respect to carrying on or doing business for any part of such year an excise tax of $1 for each $1,000 of the adjusted declared value of its capital stock.

* * *

(d) Every corporation liable for tax under this section shall make a return under oath within one month after the close of the year with respect to which such tax is imposed to the collector for the district in which is located its principal place of business or, if it has no principal place of business in the United States, then to the collector at Baltimore, Maryland. Such return shall contain such information and be made in such manner as the Commissioner with the approval of the Secretary may by regulations prescribe. The tax shall, without assessment by the Commissioner or notice from the collector, be due and payable to the collector before the expiration of the period for filing the return. If the tax is not paid when due, there shall be added as part of the tax interest at the rate of 6 per centum per annum from the time when the tax became due until paid. All provisions of law [illegible] of the taxes

making the returns and paying the taxes imposed by this section, under such rules and regulations as he may prescribe with the approval of the Secretary, but no such extension shall be for more than sixty days.

(e) Returns required to be filed for the purpose of the tax imposed by this section shall be open to inspection in the same manner, to the same extent, and subject to the same provisions of law, including penalties, as returns made under Title II of the Revenue Act of 1926.

(f) For the first year ending June 30 in respect of which a tax is imposed by this section upon any corporation, the adjusted declared value shall be the value, as declared by the corporation in its first return under this section (which declaration of value cannot be amended), as of the close of its last income-tax taxable year ending at or prior to the close of the year for which the tax is imposed by this section (or as of the date of organization in the case of a corporation having no income-tax taxable year ending at or prior to the close of the year for which the tax is imposed by this section). For any subsequent year ending June 30, the adjusted declared value in the case of a domestic corporation shall be the original declared value plus (1) the cash and fair market value of property paid in for stock or shares, (2) paid in surplus and contributions to capital, (3) its net income, (4) the excess of its income wholly exempt from the taxes imposed by the applicable income tax law over the amount disallowed as a deduction by section 24(a)(5) of the Revenue Act of 1934 or a corresponding provision of a later Revenue Act, and (5) the amount of the dividend deduction allowable for income tax purposes, and minus (A) the value of property distributed in [illegible] distributions of earn-

come; adjustment being made for each income-tax taxable year included in the period from the date as of which the original declared value was declared to the close of its last income-tax taxable year ending at or prior to the close of the year for which the tax is imposed by this section. The amount of such adjustment for each such year shall be computed (on the basis of a separate return) according to the income tax law applicable to such year. For any subsequent year ending June 30, the adjusted declared value in the case of a foreign corporation shall be the original declared value adjusted (for the same income-tax taxable years as in the case of a domestic corporation), in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, to reflect increases or decreases in the capital employed in the transaction of its business in the United States.

* * *

SEC. 106. EXCESS-PROFITS TAX [as amended by Section 402 of the Revenue Act of 1936, c. 690, 49 Stat. 1648].

(a) There is hereby imposed upon the net income of every corporation for each income-tax taxable year ending after the close of the first year in respect of which it is taxable under section 105, an excess-profits tax equal to the sum of the following:

6 per centum of such portion of its net income for such income-tax taxable year as is in excess of 10 per centum and not in excess of 15 per centum of the adjusted declared value;

12 per centum of such portion of its net income for such income-tax taxable year as is in excess of 15 per centum of the adjusted declared value.

(b) The adjusted declared value [illegible]

preceding income-tax taxable year (or as of the date of organization if it had no preceding income-tax taxable year). If the income-tax taxable year in respect of which the tax under this section is imposed is a period of less than 12 months, such adjusted declared value shall be reduced to an amount which bears the same ratio thereto as the number of months in the period bears to 12 months. For the purposes of this section the net income shall be the same as the net income for income tax purposes for the year in respect of which the tax under this section is imposed, computed without the deduction of the tax imposed by this section, but with a credit against net income equal to the credit for dividends received provided in section 26(b) of the Revenue Act of 1936.

(c) All provisions of law (including penalties) applicable in respect of the taxes imposed by Title I of the Revenue Act of 1934, as amended, shall, insofar as not inconsistent with this section, be applicable in respect of the tax imposed by this section, except that the provisions of section 131 of that title shall not be applicable.

* * *

Treasury Regulations 64 (1936 Ed.):

ART. 44. *Original declared value* [as amended by T. D. 4667, XV-2 Cum. Bull. 312, 314].— (*a*) In its first return a corporation must declare a definite and unqualified value for its capital stock. "First return" means the first capital stock tax return filed by a corporation for its first taxable year under section 105. Extreme care should be exercised in making this original declared value, for the reason that if a return has been filed disclosing a declared value, such value cannot be changed, amended, or corrected, either by the corporation or by the Commissioner. A subsequent return declaring a different

value, even though filed before the expiration of the prescribed period, is therefore not acceptable under the statute. The importance of the original declared value may be seen from the fact that such original declared value forms the basis for the computation of the tax on capital stock in years subsequent to the first taxable year, and constitutes a prime factor in determining the amount of tax imposed on excess profits under section 106 of the Revenue Act of 1935, as amended by section 402 of the Revenue Act of 1936.

* * *

ART. 45. *Adjusted declared value.*—(*a*) *First taxable year.*—The adjusted declared value for the first taxable year is the original declared value.

If a corporation was in existence during the entire taxable year ended June 30, 1936, the adjusted declared value shall be as of the close of its last income-tax taxable year which ended prior to July 1, 1936. If a corporation makes its Federal income tax return on a calendar year basis, the value declared must be as of December 31, 1935. If a corporation makes its income tax return on a fiscal year basis, the value must be declared as of the close of such fiscal year ended prior to July 1, 1936.

* * *

T. D. 4971, 1940-1 Cum. Bull. 236:

5. Article 44 (a) of Regulations 64 (Capital Stock Tax), approved May 6, 1936, as amended by Treasury Decision 4667, approved July 18, 1936, is amended to read as follows:

(*a*) In its first return a corporation must declare a definite and unqualified value for its capital stock. Extreme care should be exercised in making this original declared value, for the reason that if a return

has been filed disclosing a declared value, such value cannot be changed, amended, or corrected, either by the corporation or by the Commissioner after the expiration of the statutory period (or any extension thereof) within which the return is required to be filed. The importance of the original declared value may be seen from the fact that such original declared value forms the basis for the computation of the tax on capital stock in years subsequent to the first taxable year, and constitutes a prime factor in determining the amount of tax imposed on excess profits under section 106 of the Revenue Act of 1935.

SUPREME COURT OF THE UNITED STATES.

No. 248.—October Term, 1941.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, *vs.* Lerner Stores Corporation (Md.)	On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[December 22, 1941.]

Mr. Justice Douglas delivered the opinion of the Court.

This is a companion case to *Scaife Co.* v. *Commissioner*, No. 57, decided this day. The tax in dispute is respondent's excess profits tax for the fiscal year 1937. Respondent filed a timely capital stock tax return for the first year ended June 30, 1936, in which the declared value of its capital stock was stated to be $25,000. This return was filed September 27, 1936, an extension of time until September 29, 1936 having been obtained. The figure of $25,000 was erroneous due to a mistake made by an employee of respondent. When the error was discovered an amended return was tendered in which the declared value of the capital stock was given as $2,500,000. This was on January 27, 1937, more than sixty days after the statutory due date. The amount of the tax, penalty and interest on the higher amount was tendered. The amended return was not accepted and the amount of the remittance was refunded. Petitioner, in determining respondent's net income subject to the excess profits tax for the fiscal year ended January 31, 1937, used the declared value of $25,000 appearing in the original return. The order of the Board of Tax Appeals sustaining the Commissioner was reversed by the Circuit Court of Appeals. 118 F. 2d 455.

On the issue of timeliness of the amended return the decision in the *Scaife* case is determinative. The case for disallowance of the amendment is even stronger here, for the amended return was filed beyond the period for which any extension could have been granted by the Commissioner. The hardship resulting from the misplaced decimal point is plain. But Congress not the courts is the source of relief.

Respondent in its brief tenders another issue. It contends here, as it did before the Board and the Circuit Court of Appeals, that §§ 105 and 106 of the Revenue Act of 1935 constitute an unlawful delegation of legislative authority contrary to Art. 1, Sec. 8 of the Constitution, that they violate the Fifth Amendment; and that the capital stock and excess profits taxes being "based on guesses and wagers" are beyond the delegated powers of Congress. The Board and the Circuit Court of Appeals ruled adversely to respondent on these constitutional issues. Respondent filed no cross-petition for certiorari. Yet a respondent, without filing a cross-petition, may urge in support of the judgment under review grounds rejected by the court below. *Langnes* v. *Green*, 282 U. S. 531, 538-539; *Public Service Commission* v. *Havemeyer*, 296 U. S. 506, 509; *McGoldrick* v. *Compagnie Generale Transatlantique*, 309 U. S. 430, 434.

The constitutional issues however are without substance. As we noted in *Haggar Co.* v. *Helvering*, 308 U. S. 389, 391-392, 394, the capital stock tax and the excess profits tax are closely interrelated. The declared value of the capital stock is the basis of computation of both taxes. The declared value for the first year is the value declared by the corporation in its first return; the declared value for subsequent years[1] is the original declared value as changed by certain specified capital adjustments. Sec. 105(f), Revenue Act of 1935, 49 Stat. 1014, 1018. The taxpayer is free to declare any value of the capital stock for the first year which it may choose. While a low declaration of value decreases the amount of the capital stock tax, it increases the risk of a high excess profits tax. On the other hand, a high declaration of value while decreasing the tax on excess profits, increases the capital stock tax. By allowing the taxpayer "to fix for itself the amount of the taxable base" for purposes of computation of these taxes, Congress "avoided the necessity of prescribing a formula for arriving at the actual value of capital—" a problem "which had been found productive of much litigation under earlier taxing acts". *Haggar Co.* v. *Helvering*, *supra*, p. 394. See 1 Bonbright, Valuation of Property, pp. 577-594.

[1] There is no limitation of time on the use of the original declared value under the 1935 Act. It should be noted, however, that § 1202 of the Internal Revenue Code (see § 601(f) of the Revenue Act of 1938, 52 Stat. 447, 565) provides that the "adjusted declared value shall be determined with respect to three-year periods beginning with the year ending June 30, 1938, and each third year thereafter." That adjusted declared value enters into the computation of the excess profits tax under §§ 600 and 601 of the Internal Revenue Code.

"At the same time it guarded against loss of revenue to the Government through understatements of capital" by providing a formula which would in such circumstances result in an increase in the excess profits tax. *Haggar Co.* v. *Helvering, supra,* p. 394.

There is present no unlawful delegation of power. Congress has prescribed the method by which the taxes are to be computed. The taxpayer here is given a choice as to value. While the decision which it makes has a pronounced effect upon its tax liability, that is not uncommon in the tax field. Congress has fixed the criteria in light of which the choice is to be made. The election which the taxpayer makes cannot affect anyone but itself.

The contention that these provisions of the Act run afoul of the Fifth Amendment is likewise without merit. A claim of unreasonable classification or inequality in the incidence or application of a tax raises no question under the Fifth Amendment which contains no equal protection clause. *La Belle Iron Works* v. *United States,* 256 U. S. 377; *Sunshine Anthracite Coal Co.* v. *Adkins,* 310 U. S. 381, 401. The propriety or wisdom of a tax on profits computed in reference to a specified criterion of value of capital stock is not open to challenge in the courts. *La Belle Iron Works* v. *United States, supra,* p. 393. That being true there is no constitutional reason why Congress may not because of administrative convenience alone (*Carmichael* v. *Southern Coal & Coke Co.,* 301 U. S. 495, 511 and cases cited) avoid litigious valuation problems and rely on the self-interest of taxpayers to place a fair valuation on their capital stock. As was stated in *Rochester Gas & Electric Corp.* v. *McGowan,* 115 F. 2d 953, 955, "To say that Congress could not choose a scheme implemented by such mild sanctions, as an alternative to actually computing an 'excess profits tax' with all the uncertainty and litigation which that had involved, would be most unreasonably to circumscribe its powers to establish a convenient and flexible fiscal system."

Nor do we have here any lack of that territorial uniformity which is required by Art. 1, § 8 of the Constitution. *La Belle Iron Works* v. *United States, supra,* p. 392.

Reversed.

A true copy.

Test:

Clerk, Supreme Court, U. S.